

Low-Income Rental Housing Tax Credit and Mortgage Revenue Bonds: Expiring Provisions Extended

Currently, a tax credit is allowed for the construction, rehabilitation, or acquisition of qualifying low-income rental housing. The credit is allocated by state or local government authorities subject to an annual limitation for each state. The 1989 deficit reduction legislation reduced the credit allocation from \$1.25 to \$0.9375 per state resident and extended it only through September 30, 1990. RRA restored the credit allocation for 1990 to \$1.25 per state resident and also extended it through December 31, 1991.

State and local governments can issue tax-exempt bonds and use the proceeds to provide low-interest-rate mortgage loans for homeowners with family incomes below a certain level. RRA extended the authority of state and local governments to issue tax-exempt qualified mortgage revenue bonds or mortgage credit certificates from October 1, 1990 through December 31, 1991. Also, the provisions for recapture of the tax subsidies in cases where homes are sold within nine years were also modified.

Estate Freezes:

Repeal of the "Anti-Freeze" Provisions to Estate Planning, You Can't Take It with You, But Now Your Heirs Can.

Before December 17, 1987, business founders could transfer future growth to their heirs in the form of common stock, initially worth little but entitled to all the future appreciation, while freezing the rest of value of their business in the form of preferred stock. Because preferred stock's value remains on the books at par no matter how the business grows, the transaction thereby will freeze the value of business in the parents' estate at its current value, while transferring all future appreciation to the children, keeping the business' future appreciation from being taxed as part of the parents' estate upon their death.

In 1987, Section 2036(c) was enacted to prevent an owner of a substantial interest in an "enterprise" from using estate freeze to avoid transfer taxes by minimizing the transferred or gifted portion and therefore reducing potential gift taxes on the transferred interest. Section 2036(c) was designed to eliminate estate freezes and similar

transfers of growth interests to heirs in family-owned businesses.

Section 2036(c) provided that any transfer to a family member of an interest in property that had a disproportionate share of the potential growth of an enterprise could later be brought back and taxed in the estate of the transferor. This estate tax inclusion procedure was criticized by the business community, the bar, and the accounting profession as a substantial barrier to estate planning for those who wish to keep family businesses in the family after their death. The draconian approach exposed large portions of family businesses to 55 percent estate tax rates upon the death of the founder, in some cases forcing the liquidation of many businesses to pay the estate tax.

RRA repealed the estate-freeze provisions of section 2036(c) retroactive to the date of enactment. It permitted freezes and transfers of growth interests but provided new stringent valuation rules on the value of preferred stock retained by parents. The new rules, as complex as the old ones, are supposed to value transfers of assets for gift tax purposes more accurately by focusing on the value of property at the time of transfer instead of at the time of death. Contrary to the rule after December 17, 1987, once the value of transfers of interests is figured out, the transferred assets will not later be subject to taxation in the estate of the transferor. The provision is effective for transfers occurring after October 8, 1990.

The new law, although considered as good news for small businesses, raises some new obstacles. It forces heavy gift taxes on the portion of the business transferred to heirs at the time of the transfer therefore requiring large cash payments for typically a cashless transaction. The new valuation rule also raises concerns about how the Internal Revenue Service will interpret the law. The Agency reported that the new estate-freeze rules will be issued in the spring. In the mean time, estate planning itself seems to be frozen while many business owners are adopting a wait-and-see attitude. At the moment, the best advice, on estate freezes seems to be the one given by a family business owner, "Don't die."¹⁰

Conclusions

RRA raised the top marginal income tax rate from 28 percent to 31 percent. The bubble in the marginal tax rate has been shrunk. Tax liability

for higher-income taxpayers has been increased through the increase in the top rate and the alternative minimum tax, the phaseout of the personal exemptions, and limitation on itemized deductions. Those in the bottom brackets received a significant increase in the refundable earned income tax credit. The largest tax increase will come from the increase in excise tax such as gasoline and from the hospital insurance tax on high-income workers. Few provisions affect the real estate industry directly. The capital gains tax rate was capped at 28 percent. The low-income housing credit and mortgage revenue bonds were extended. Significant changes in estate tax freezes were made. However, no major changes for tax-free exchange or passive loss rules were made.¹¹

by

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Endnotes

¹ For details of the bubble in the marginal tax rate under TRA, see Leavens (1990).

² See, for example, Grey (1990) and Godfrey (1990).

³ See Cohen (1990).

⁴ See Godfrey (1990) who gives examples of both winners and losers under RRA. For example, under TRA, the phased-out range of the personal exemptions for joint filers claiming four exemptions would be between the levels of taxable income of \$160,000 and \$205,000. Under RRA, such families would start losing their personal exemptions deduction sooner at the level of taxable income of \$120,000 and would completely lose all the deduction at \$235,000 of taxable income. Because the phase-out range is stretched longer under RRA, families between taxable incomes beyond the old phase-out range of \$205,000 up until \$235,000 would find themselves regaining some of the personal exemptions they lost under TRA.

⁵ See Davis (1990) for other examples of how separate filing after 1990 will benefit some married couples.

⁶ See Suwalsky, Jr. (1990), p. 251, quoting the number from the Bureau of the Census.

⁷ The floor on itemized deduction differs from a simple tax increase in one important point: it is based on AGI rather than taxable income.

⁸ For example, IRS data reported that 977 out of 65,303 taxpayers with AGI above \$1 million did not itemize in 1988 and thus would experience no tax increase under this provision. An additional three or four percent of itemizers would also have a lower increase under this provision than a comparable rate increase because of the 80-percent exclusion factor. See Hoerner (1990).

⁹ See Steuerle (1990) for details how a capital gains differential creates a complex situation among taxpayers and tax preparers.

¹⁰ See Shellenbarger (1991).

¹¹ RRA modifies the \$25,000 rental real estate deduction equivalent allowance allowed by TRA. Under the modification, the \$200,000 to \$250,000 AGI phaseout of the allowance is eliminated for purposes of the low-income housing tax credit. This modification is effective for property placed in service after 1989 where the taxpayer's interest in such property is also acquired after 1989.

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U.S. Economic Outlook: February 1991

Quarterly figures are seasonally adjusted annual rates

	90.3	90.4	91.1	91.2	91.3	91.4	92.1	92.2	1989	1990	1991	1992	1993
U.S. Economy													
<i>Annual Growth Rate</i>													
Real GNP	1.4	-2.1	-1.8	-0.4	2.6	3.1	3.2	2.9	2.5	0.9	-0.2	2.7	2.4
Industrial Production	4.0	-8.0	-6.9	-3.5	1.2	3.8	4.4	4.9	2.6	1.0	-2.9	3.4	3.1
Civilian Employment	-1.3	-0.9	-1.3	-0.8	0.1	0.8	1.1	1.4	2.0	0.5	-0.7	0.9	1.3
GNP Inflation Index	3.7	2.8	3.5	2.9	2.8	2.4	2.8	2.5	4.1	4.1	3.2	2.7	2.7
Consumer Prices	6.4	6.9	4.1	2.7	3.5	3.5	3.6	3.5	4.8	5.4	4.5	3.5	3.3
Value of the U.S. Dollar	-20.7	-19.0	-1.9	-7.7	-1.4	-2.0	-3.1	-2.0	6.2	-9.6	-8.9	-2.1	1.2
<i>Percent</i>													
Mfg. Capacity Utilization	82.8	80.5	78.7	77.7	77.6	78.0	78.6	79.3	83.9	82.2	78.0	79.6	80.9
Civilian Unemployment	5.6	5.9	6.3	6.6	6.7	6.6	6.4	6.2	5.3	5.5	6.5	6.1	5.7
<i>Percent of GNP</i>													
Federal Tax Receipts	20.4	20.6	20.6	20.5	20.7	20.8	20.9	20.9	20.2	20.3	20.6	20.9	20.8
Federal Expenditures	23.1	23.8	23.7	23.8	23.6	23.6	23.6	23.3	22.8	23.3	23.7	23.3	23.0
Federal Budget Deficit	-2.6	-3.0	-3.1	-3.2	-2.9	-2.8	-2.7	-2.4	-2.6	-3.0	-3.0	-2.4	-2.3
<i>Interest Rates, Percent</i>													
Federal Funds Rate	8.2	7.7	6.6	6.3	6.5	6.7	7.0	6.9	9.2	8.1	6.6	7.0	7.2
3-Month T-Bill Rate	7.5	7.0	6.0	5.9	5.9	6.0	6.2	6.1	8.1	7.5	5.9	6.2	6.3
Prime Rate	10.0	10.0	9.1	9.0	9.0	9.2	9.5	9.5	10.9	10.0	9.1	9.5	9.5
Discount Rate	7.0	6.9	6.1	5.8	5.8	5.9	6.0	6.0	6.9	7.0	5.9	6.1	6.5
Corporate AAA Bond Yield	9.4	9.3	8.8	8.4	8.3	8.3	8.4	8.4	9.3	9.3	8.5	8.4	8.2
30-Year Government Bond Yield	8.8	8.5	8.1	7.7	7.7	7.8	7.9	7.9	8.4	8.6	7.8	7.9	7.8
<i>Mortgage Rates, Percent</i>													
30-Year Fixed Rate	10.1	10.0	9.3	9.1	9.0	9.0	9.0	8.9	10.3	10.1	9.1	8.9	8.8
1-Year Adjustable	8.4	8.1	7.8	7.5	7.4	7.4	7.4	7.5	9.3	8.4	7.5	7.5	7.5
Home Sales & Starts													
<i>Thousands</i>													
Total Single-Family Sales	4,164	3,904	3,824	3,941	4,074	4,212	4,326	4,467	4,446	4,182	4,013	4,473	4,626
(Single-family resales plus 97% of single-family starts)													
Existing Single-Family Sales	3,333	3,140	3,085	3,163	3,240	3,333	3,415	3,517	3,467	3,304	3,205	3,523	3,681
New Single-Family Sales	524	476	472	483	498	519	537	551	654	534	493	556	594
Housing Starts	1,130	1,047	988	1,001	1,059	1,113	1,173	1,228	1,386	1,209	1,040	1,232	1,260
Single-Family Units	857	787	762	803	860	906	939	980	1,010	905	833	979	975
Multi-Family Units	273	259	226	198	199	207	234	249	377	303	208	253	285
2-4 Family Units	31	28	25	22	22	23	26	27	55	37	23	28	31
5+ Family Units	242	231	201	177	177	184	208	221	321	267	185	225	254
Mobile Homes Shipped	187	181	182	199	219	233	242	246	199	189	208	246	240
<i>Percent change - Year Ago</i>													
Total Single-Family Sales	-5.5	-13.2	-14.5	-5.9	-2.2	7.9	13.1	13.3	-4.3	-5.9	-4.1	11.5	3.4
Existing Single-Family Sales	-3.2	-11.2	-9.9	-4.7	-2.8	6.1	10.7	11.2	-3.6	-4.7	-3.0	9.9	4.5
New Single-Family Sales	-25.0	-26.7	-20.3	-10.5	-5.0	8.6	13.8	14.1	-3.3	-18.4	-7.6	12.7	6.8
Housing Starts	-15.5	-22.3	-32.1	-16.8	-6.3	6.3	18.7	22.7	-7.0	-12.8	-14.0	18.4	2.3
Single-Family Units	-13.9	-20.3	-29.6	-10.3	0.3	15.0	23.2	22.0	-7.0	-10.3	-8.1	17.6	-0.5
Multi-Family Units	-20.2	-27.9	-39.1	-35.9	-27.2	-20.2	3.5	25.5	-7.1	-19.5	-31.6	21.8	12.9
2-4 Family Units	-44.6	-46.9	-43.0	-50.4	-29.8	-20.2	3.5	25.5	-5.7	-34.0	-38.0	21.8	12.9
5+ Family Units	-15.4	-24.6	-38.6	-33.5	-26.8	-20.2	3.5	25.5	-7.3	-16.9	-30.7	21.8	12.9
Median Home Prices													
<i>Thousands of Dollars</i>													
Existing Home Prices	96.6	92.2	92.9	94.2	95.3	97.7	100.3	100.9	92.9	95.2	95.0	101.6	106.5
New Home Prices	116.7	124.3	121.9	122.6	123.6	125.7	127.1	129.1	120.4	122.7	123.4	130.2	137.1
<i>Percent Change - Year Ago</i>													
Existing Home Prices	1.8	-0.5	-3.2	-2.1	-1.4	5.9	8.0	7.1	4.2	2.5	-0.3	6.9	4.9
New Home Prices	-2.5	-0.1	-1.0	-3.2	5.9	1.1	4.3	5.3	6.2	1.9	0.6	5.5	5.3

Source: Forecast produced using Laurence H. Meyer & Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Robert Barr and Kimberly Martin.

The *Real Estate Outlook* features a monthly summary of current economic conditions, an easy-to-read forecast for the economy and real estate, and selected reports on issues affecting the housing industry. In addition, one of the Nation's top real estate economists, Dr. John Tuccillo, gives his commentary on the state of the economy and its implications for real estate markets. If you would like to subscribe to the *Real Estate Outlook*, contact the Forecasting and Policy Analysis Division at (202) 383-1131. The annual subscription fee is \$25 for members of the NATIONAL ASSOCIATION OF REALTORS® and \$30 for nonmembers.



OUTLOOK

A Monthly Forecast for the Economy and Real Estate



FORECAST SUMMARY

- The forces that were pushing the U.S. toward recession before the Persian Gulf crisis remain with us, even with oil prices below their pre-invasion levels and the Iraqis defeated. Consumer confidence fell precipitously last autumn as the U.S. braced itself for war and realized that it had stumbled into a recession. Reviving consumer confidence is an important requisite of economic recovery, but it's not the only one. Recovery depends upon such economic fundamentals as job growth, income gains, inflation and interest rates.
- Most of the available data suggests that the rebound has not begun yet but will arrive by mid-year. After declining 1.1 percent in the first half of 1991, the economy is expected to post a healthy 3.2 percent annual growth rate in the second half of 1991. Lower interest rates and lower inflation will make important contributions to reviving the economy.
- Despite last year's agricultural and energy price shocks, the inflationary spirals reminiscent of the 1970s have not shown up so far in the 1990s. Falling oil prices and the recession are playing an important role in restraining price increases. The Fed initiated another cut in its federal funds rate target, indicating the Fed thinks the economy and the fragile banking system need more help.
- Single-family dwellings accounted for most of the 12.8 percent decline in housing starts in January. The month's annual rate of 850,000 units is 45 percent below that recorded in January 1990, and represents the lowest level since January 1982. Among these troubling figures are some signs of recovery, especially lower mortgage rates and reviving consumer confidence.
- New home sales declined to 408,000 units in January, their lowest level since August of 1982. Anecdotal evidence indicates that the deterioration of sales in January is characteristic of the first half of the month. Increased traffic in the second half of January suggests that the seeds of a modest recovery in the housing sector have been planted.

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The Size of the Fight in the Dog

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On the same day in February, spring training opened, James Brown was paroled and the war in the Persian Gulf ended. This is noted not to trivialize the war, but rather to point out how size, power and control are not always what they seem. And therein lies a tale for real estate in the Nineties.

We now know -- as we did not during the fighting -- how outnumbered coalition ground forces were in Kuwait. The Iraqi Army, fourth (oops, sixth; oops, tenth) largest in the world was nearly half against the size of the allies, and even that advantage was magnified by the fact that Iraq fought in the defensive. And while our technology and firepower were overwhelming, the ground forces were seemingly tabbed for massive losses in any attack.

That didn't happen by a long shot. It was averted by the adroit use of information by the allied forces to equalize size. Air attacks eliminated the ability of the Iraqis to "see" the battlefield, allowing three separate feints to persuade them of an amphibious landing that never came. The press (ironically, in light of the Vietnam experience) was used to mislead the Iraqis as to troop strengths. In short, the war was ultimately won through firepower, firepower, and *information power*.

Real estate centers completely around information. From MLS systems to mortgage lending terms, the value added by REALTORS® includes the provision of information to buyers and sellers so that they can make better decisions. But, information also has an impact on the success of the real estate firm.

Correctly used, it decides who will be the lead dog and who will be one of the pack. In a world of print and the leisurely spread of news, equality of information power was common. What did it matter what you knew and when you knew it if everyone had the same access? But that's not today's world. The war showed us how the instantaneous acquisition and processing of information has a real impact on reality. And differential access to information is reality.

* * *

It's fitting that spring training began as American victory was assured. Both bring vividly into mind the values that make this country great. But as baseball returns, we are reminded of the "impossible" World Series sweep of the targeted-for-defeat Cincinnati Reds last October. They simply *couldn't* win. The A's were more powerful; the A's had better pitching; the A's had momentum; the A's even had better looking families. But games are played on the field, not on paper, and the Reds did win.

Why? The stupid answer is that they scored more runs than the A's in each game. The more subtle response is that for a five day period in October, enough players wearing the Cincinnati uniform had career performances to assure that the underdog of dogs prevailed.

Baseball can only be played with nine men at a time. If the A's had more quality talent, it only meant that they had a higher probability (not certainty) that some players would be playing well. But the nine the Reds put out consistently bettered the nine that Oakland played. Then, it didn't matter how many quality players sat on the benches; they never figured in the outcome.

Cincinnati won because it produced "size equivalency." Within the arena and within the terms of the game, it was as strong and as deep and as powerful as was Oakland. It wasn't the size of the dog in the fight here that mattered.

And thereby hangs a tale. The real estate business is very competitive, and the pressures on company costs will only make it more so in the future. Size and power are clearly an advantage, since market penetration and familiarity are often the only indicators the public goes on. But, smaller firms who have established reputations for service and expertise in well-defined sectors of the market can appear to be the equivalent of much larger firms.

That's really not a new concept; after all, it's one of the bases of the franchise movement. But, marry it with considerations about the use of information and some new guidelines develop.

One of the major changes in our society has been the hammering down of information costs and our increasing comfort with receiving more and more information from a variety of sources. This suggests the development of a clientele that will be impressed with the effective organization and presentation of facts and analysis that will further its decision process.

Here is the key to size equivalency. As the Nineties proceed, the premium placed on the timely provision of real estate market information will increase. Those who can access and organize that information will capture that premium and market success.

We are entering a decade in which the keys to profitability will more and more center around a computer screen and a fax machine. In that kind of world, where information is democratized, size is less a matter of the number of people or offices and more a matter of the skill with which the universal good -- information -- is manipulated.

* * *

Where does James Brown enter all this? Probably just as a device to note that the end of the war will likely coincide (when all the numbers are in) with the end of the recession. The burst of consumer confidence that accompanied the cease fire will bring the real estate market, and the entire economy, around by mid-year. As the Godfather of Soul sang on his release, so too does the American consumer: "I feel good!"

Outlook for the Economy and Real Estate

As the final straw to break the expansion's back, the Persian Gulf crisis has been tightly linked to the current recession. Now that the U.S. has orchestrated an overwhelming victory overseas, is the return of economic growth imminent? While a rebound in consumer confidence is widely anticipated, the recovery is expected to lag behind by a few months. The NAR forecast calls for a 2.4 percent annual rate of decline in 1991's first quarter and slight growth of 0.2 percent in the second quarter. By mid-year a recovery will be in place, and growth will pick up to a 3.2 percent rate in the year's second half.

The Roots of the Recession

The Persian Gulf crisis can only be said to be a contributor to the recession, not the cause. Housing starts, consumer confidence, corporate profits, and growth in real personal income were all sliding before the Iraqi invasion of Kuwait. Inflation had remained fairly stubborn in the face of two years of monetary tightening designed to eliminate it, and purchasing power was eroding. Moreover, manufacturing firms were struggling, with job losses recorded in sixteen of the eighteen months between February 1989 and July 1990. On net, 406,000 manufacturing workers lost their jobs during this period. Meanwhile, the S&L bailout added billions to the federal budget deficit, and the embattled American president broke his most prominent campaign pledge in June by placing tax increases on the budget negotiating table. In sum, there were powerful forces pushing the U.S. toward recession well before the events of August 2.

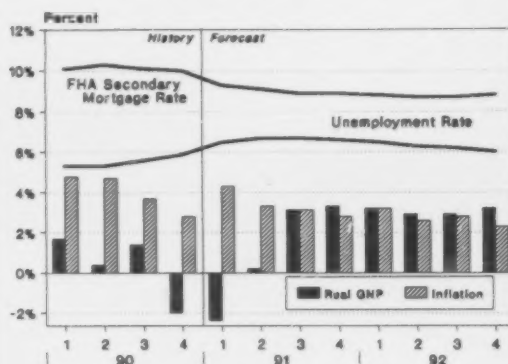
Many of these forces remain with us, even with oil prices below their pre-invasion levels and the Iraqis defeated. Just as the downturn wasn't caused solely by Saddam, his defeat alone won't spell relief from the recession. It's an important roadblock removed, but recovery depends on such economic fundamentals as job growth, income gains and interest rates. Most of these indicators suggest not an immediate recovery but a rebound by mid-year.

The Consumers' Diet

The slowdown in consumer spending predates the summer of 1990. The chart at right shows just how much consumers cut back in the past two years relative to the 1983-89 expansion averages. During 1989-90, total spending grew at only a 0.7 annual rate, only one-fifth of its annual average of 3.6 percent during most of the Eighties. Purchases of durables, goods which are expected to last at least three years, climbed at a 7.1 percent annual average during the expansion but fell at a 1.4 percent rate in 1989-90. Clearly, consumers were feeling the squeeze of higher inflation, higher debt levels, higher expected taxes, and slower job growth. These concerns have not disappeared with the decimation of the Iraqi Republican Guard.

Much attention has been paid to consumer confidence, which fell precipitously last autumn as the U.S. both braced itself for war and realized that it had stumbled into a recession. With consumer expenditures making up two-thirds of total demand, its 2.9 percent decline during the fourth quarter was a critical drag on the economy. Another decline is expected in the current quarter. Reviv-

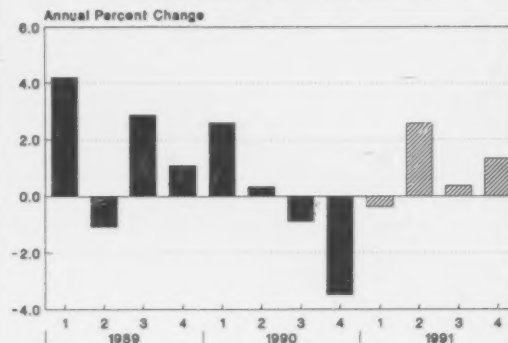
The Economic Outlook



Sources: Bureau of Economic Analysis; NAR forecast

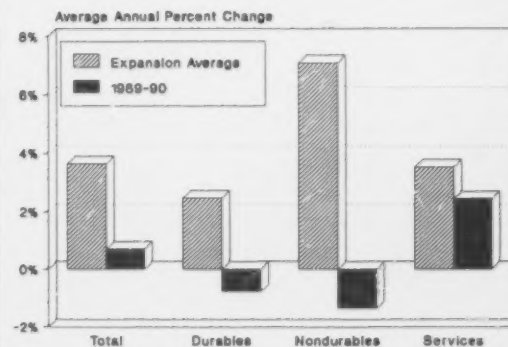
Eroding Purchasing Power

Change in Real Disposable Personal Income



Source: Bureau of Economic Analysis

Drop in Consumption Expenditures Isn't New



Source: Bureau of Economic Analysis

ing consumer confidence is an important requisite of the recovery, but it's not the only one. Consumers spend income, not confidence, and it's not until more income is generated that a solid recovery will take root.

In terms of job growth, it appears that the recession remained very much with us during February. Another 184,000 jobs were lost during the month, and the unemployment rate rose to 6.5 percent from 6.2 percent. Over the past seven months, payrolls have been cut by over a million jobs, not including some auto industry layoffs, which were announced after the employment survey was complete. Bearing the brunt of the reduction has been manufacturing and construction, but services have been vulnerable as well.

Inventories Suggest Recession to Remain Mild

Inventories are playing a peculiar role during the current recession -- a role which supports the case for a mild recession. Typically, unsold merchandise stacks up at the beginning of a recession as demand (usually termed final sales) dwindles. In response, businesses slash production, reduce employment and sell out of inventories until sales revive. But in the first full quarter of the current recession, inventories fell by a steep \$22.2 billion and final sales eeked out a small gain of 0.6 percent. Without the typical inventory build-up, the deep production cuts usually seen may be avoided during the current recession. Perhaps with the exception of the auto industry, inventories remain well under control, auguring well for a recovery by mid-year.

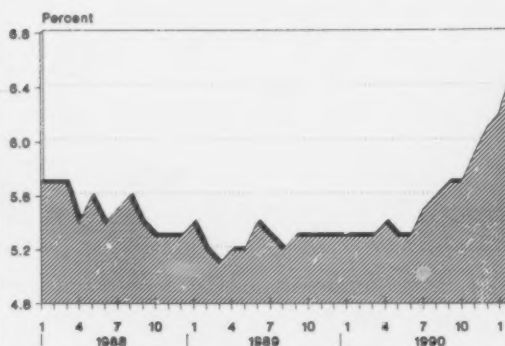
Recession's Silver Lining: Reduced Inflation

Inflation appears to be another bright spot. Despite last year's agricultural and energy price shocks, the inflationary spirals reminiscent of the 1970s have not shown up so far in the 1990s. One sign of this is the subdued increase in average hourly earnings. The chart to the right shows how wage growth appears to be decelerating relative to the annual averages of the 1970s and 1980s. And relief is apparent in consumer prices as well. After increasing 6.3 percent rate from the end of 1989 to the end of 1990, the consumer price index is expected to post a 3.3 percent gain by the end of 1991. Falling oil prices and the recession are playing an important role in restraining price increases.

This relatively tame rate of inflation gives the Federal Reserve some additional room to ease. As it did last month, the Fed initiated another cut in its federal funds rate target when the employment figures were released. If the Fed thought the economy had reached bottom, the cut probably would not have come, and the Fed would have waited for additional data to confirm their suspicions about a rebound. But apparently the Fed thinks the economy needs more help. Of course, too much monetary stimulus means additional inflation ahead, and it's inflation that the Fed has sought to fight over the past couple of years with its policy of monetary restraint. The 1988-90 episode of tightening is seen in the chart at right, which also shows the modest increase in reserve growth anticipated in 1991.

In addition to easing credit policy to end the recession, the Fed is also interested in reducing the pressure on the banking system's wobbly financial structure. Lower rates will take some bite out of the credit crunch, freeing up funds for lending.

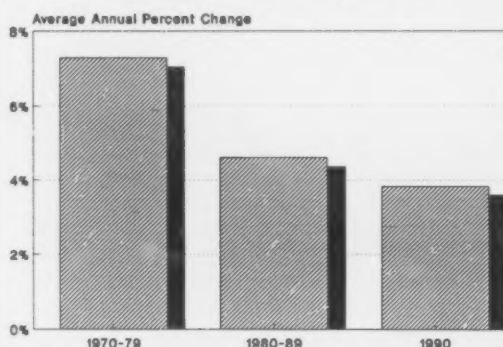
Unemployment Rate Rises



Source: Bureau of Labor Statistics

The Wage-Price Spiral Seems Unwound

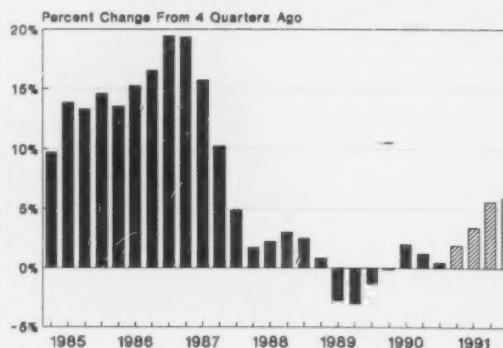
Growth in Average Weekly Earnings



Source: Bureau of Labor Statistics

The Fed's Monetary Spigot

Growth in Nonborrowed Bank Reserves



Source: Federal Reserve Board

Housing Starts

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

	Total	SF	2-4	5+
Jan 1990	1,543	1,078	53	412
Sep 1990	1,106	858	35	213
Oct 1990	1,026	839	22	165
Nov 1990	1,130	769	54	307
Dec 1990	975	749	17	209
Jan 1991	850	632	29	189
Annual Averages:				
1989	1,381	1,005	56	320
1990	1,203	901	37	265
Percent Changes in January 1991 since:				
Jan 1990	-43.9	-41.4	-45.3	-54.1
Dec 1990	-12.8	-15.6	70.6	-9.6

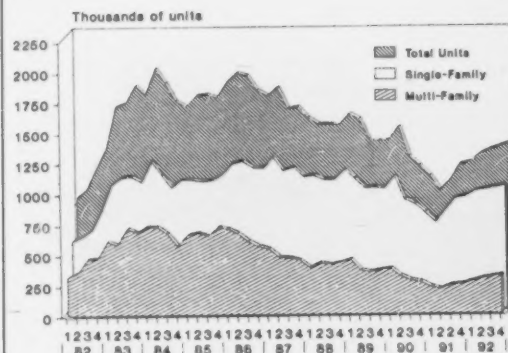
Regional Data

	Northeast	Midwest	South	West
Jan 1990	158	364	522	499
Sep 1990	104	239	445	318
Oct 1990	144	230	392	260
Nov 1990	147	232	483	268
Dec 1990	109	233	400	233
Jan 1991	77	198	340	235
Annual Averages:				
1989	181	269	535	397
1990	135	259	479	330
Percent Changes in January 1991 since:				
Jan 1990	-51.3	-45.6	-34.9	-52.9
Dec 1990	-29.4	-15.0	-15.0	0.9

Source: Bureau of the Census; Construction Reports, Series C20

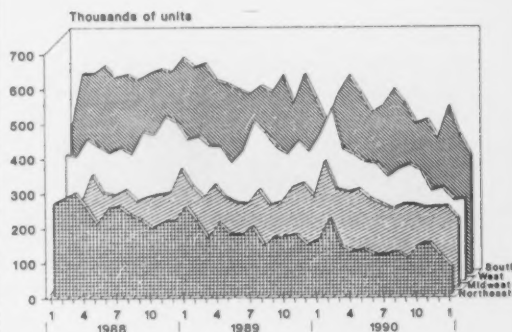
Source: Bureau of Census, Construction Reports, Series C25

Housing Starts



Source: Bureau of Census; Real Estate Outlook forecast

Housing Starts by Region



Source: Bureau of Census

The inability of home builders to obtain financing coupled with weakened consumer confidence helps to explain the sharp 12.8 percent drop in housing starts in January. The month's annual rate of 850,000 units is 45 percent below that recorded in January 1990, and represents the lowest level since January 1982. Single-family starts accounted for most of the decline, falling 15.6 percent from December to a rate of 632,000 units.

Starts in the Northeast dropped 29 percent, to a rate of 77,000 units a year. The Midwest and South had 15 percent declines, to 198,000 and 340,000 respectively, while the West posted a modest advance to 235,000 units.

Among these troubling figures are some signs of recovery. As early as the second quarter of 1991, lower

interest rates and a restoration of consumer confidence are expected to revitalize the demand for housing. Single-family starts will be more responsive to these forces, adding nearly 100,000 units to reach 808,000 units in the second quarter. On the multifamily side, the subtle credit tightening occurring in the home loan industry is making loan approvals more difficult to secure. This will restrict multifamily growth until the third quarter of 1991, when starts are expected to advance by 35,000 units to 237,000 units.

Growth in housing should be well under way by the second half of 1991. Multifamily starts are expected to increase nearly 30 percent in 1992, and single-family starts are projected to expand 18 percent.

New Home Sales

(Seasonally Adjusted Annual Rates, in Thousands)

National Data

		Mo. Ago % Chg.	Yr. Ago % Chg.
Jan 1990	627	-0.9	-10.9
Feb 1990	606	-3.3	-2.7
Mar 1990	559	-7.8	0.5
Apr 1990	534	-4.5	-12.5
May 1990	535	0.2	-17.8
Jun 1990	549	2.6	-15.0
Jul 1990	541	-1.5	-27.0
Aug 1990	525	-3.0	-27.0
Sep 1990	504	-4.0	-21.0
Oct 1990	465	-7.7	-26.9
Nov 1990	486	4.5	-29.3
Dec 1990	465	-4.3	-26.5
Jan 1991	408	-12.3	-34.9

Annual Averages:

1989	654	-3.3
1990	533	-18.3

Regional Data

	Northeast	Midwest	South	West
Jan 1990	99	106	235	187
Jul 1990	72	92	237	140
Aug 1990	63	88	236	138
Sep 1990	61	93	215	134
Oct 1990	74	70	209	113
Nov 1990	69	86	208	123
Dec 1990	65	86	194	119
Jan 1991	57	74	160	117

Annual Averages:

1989	90	103	258	202
1990	74	90	223	146

Percent Changes in January 1991 since:

Jan 1990	-42.4	-30.2	-31.9	-37.4
Dec 1990	-12.3	-14.0	-17.5	-1.7

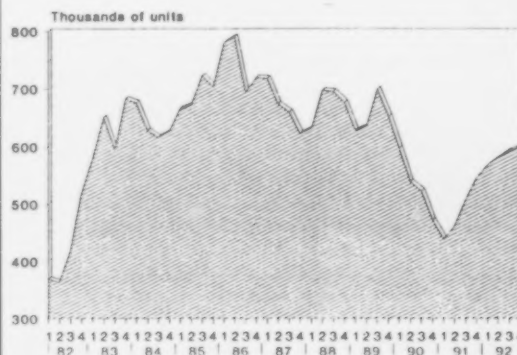
Source: Bureau of Census, Construction Reports, Series C25

New home sales declined by 12.3 percent in January as the war in the Persian Gulf and the recession intensified. Sales of new homes dropped 57,000 units to 408,000 units, their lowest level since August of 1982. Sales in January were only two-thirds of the pace set in January, 1990.

By region, the South recorded the steepest drop with sales falling by 17.5 percent to an annual rate of 160,000 units. In the Midwest, sales fell 14 percent to 74,000 units after exhibiting no growth the previous month. Sales dropped 12.3 percent, to 57,000 units, in the Northeast. In the West, sales dropped 1.7 percent to 117,000 units.

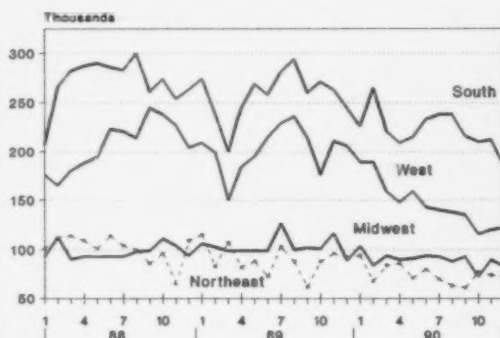
Anecdotal evidence indicates that the deterioration of sales in January is characteristic of the first half of the

New Home Sales



Source: Bureau of Census; Real Estate Outlook forecast

New Home Sales by Region



Source: Bureau of Census

month. Activity during the second half of the month hinted at a renewed interest in homebuying, perhaps in relief that the Gulf War had begun and was going so well for the U.S. The increased traffic suggests that the seeds of a modest recovery in the housing sector have been planted.

Favorable financing conditions are expected to rekindle the demand for new homes, which will be evident by the second quarter of 1991. Sales are projected to increase 5 percent to 462,000 units during the second quarter of 1991, and growth will accelerate by midyear, as sales increase by 10 percent and 7 percent in the third and fourth quarters of 1991, respectively. Sales are expected to increase by almost 20 percent in 1992.

Existing Single-Family Home Sales (Seasonally Adjusted Annual Rates, in Thousands)

National Data

		Mo. Ago % Chg.	Yr. Ago % Chg.
Jan 1990	3,470	-2.5	-5.2
Feb 1990	3,420	-1.4	-3.7
Mar 1990	3,440	0.6	0.3
Apr 1990	3,370	-2.0	-2.0
May 1990	3,350	-0.6	3.1
Jun 1990	3,370	0.6	1.2
Jul 1990	3,320	-1.5	-1.8
Aug 1990	3,410	2.7	-0.9
Sep 1990	3,160	-7.3	-10.0
Oct 1990	3,070	-2.8	-12.0
Nov 1990	3,150	2.6	-11.5
Dec 1990	3,130	-0.6	-12.1
Jan 1991	2,910	-7.0	-16.1

Annual Averages:

1989	3,467	-2.5
1990	3,305	-4.7

Regional Data

	Northeast	Midwest	South	West
Jan 1990	570	940	1,380	580
Aug 1990	520	930	1,380	570
Sep 1990	520	880	1,240	520
Oct 1990	500	820	1,240	500
Nov 1990	500	860	1,280	500
Dec 1990	500	880	1,260	490
Jan 1991	460	810	1,180	470

Annual Averages:

1989	597	931	1,320	617
1990	523	908	1,310	558

Percent changes in January 1991 since:

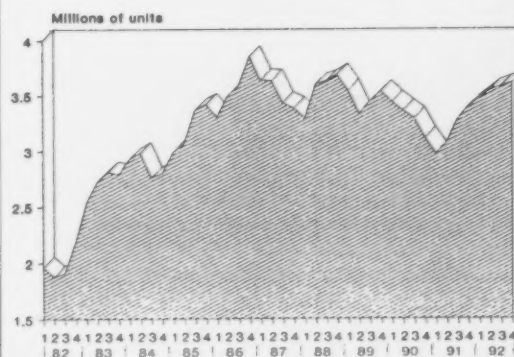
Jan 1990	-19.3	-13.3	-14.5	-19.0
Dec 1990	-8.0	-8.0	-6.3	-4.1

Source: National Association of Realtors, "Home Sales"

Favorable financing conditions in January were not enough to overcome consumers' preoccupation with the events in the Persian Gulf. Sales of existing single-family homes declined by 7 percent from December, dropping to 2,910,000 units. This represents a 16 percent decline from the year-ago figure.

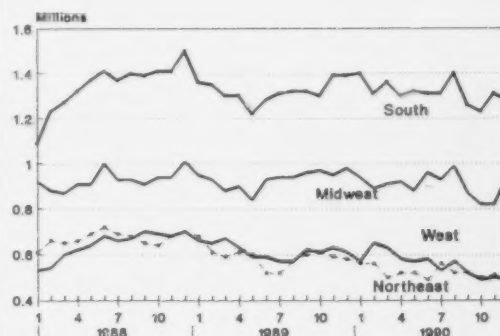
The decline in existing home sales between December and January was spread evenly among the regions. The Midwest, which has shown the greatest resistance to the recession so far, was affected by harsh weather in January. Sales in the region declined by 8 percent from December, to 810,000 units. In the Northeast, existing homes were sold at a rate of 460,000 units, down 8 percent. The South recorded a resale pace of 1.18 million units,

Existing Home Sales



Source: NAR Economics & Research; Real Estate Outlook forecast

Existing Home Sales by Region



Source: NAR Economics & Research

down 6.3 percent. Sales in the West fell by 4.1 percent from December's level of 490,000 units to 470,000 units.

Despite these widespread declines, anecdotal information from REALTORS® across the country indicates that activity started to increase at the end of January. February sales are expected to be up, and by late spring favorable mortgage rates should produce a noticeably larger volume of purchases. Sales are projected to increase by 3.6 percent in the second quarter of 1991, and the sales pace is expected to accelerate as the year continues. By the fourth quarter, sales are projected to be 424,000 units above the first quarter level. Sales will build upon this healthy pace during 1992, when sales are expected to increase by 11.5 percent.

Single-Family Home Prices

(In Dollars)

National Data

	Median		Average	
	Existing	New	Existing	New
Jan 1990	95,200	125,000	120,000	151,700
Aug 1990	97,200	118,400	120,500	144,700
Sep 1990	94,400	113,000	116,700	142,100
Oct 1990	92,900	120,000	115,900	153,000
Nov 1990	92,000	118,900	115,500	143,600
Dec 1990	91,700	126,900	114,100	152,200
Jan 1991	94,200	121,800	121,500	156,200
Annual Averages:				
1989	92,900	120,400	118,000	148,300
1990	95,200	122,100	118,300	148,900
Percent changes in January 1991 since:				
Jan 1990	-1.1	-2.6	1.3	3.0
Dec 1990	2.7	-4.0	6.5	2.6

Regional Data

Median Prices for Existing Single-Family Homes

	Northeast	Midwest	South	West
Jan 1990	143,400	72,200	85,200	147,000
Aug 1990	145,300	75,300	86,900	140,200
Sep 1990	137,100	74,200	85,900	134,700
Oct 1990	136,200	72,000	83,200	142,000
Nov 1990	134,200	71,400	83,500	139,700
Dec 1990	134,400	72,300	82,800	131,400
Jan 1991	136,900	74,500	84,300	138,200
Annual Averages:				
1989	145,100	71,200	84,400	139,800
1990	141,700	73,800	85,500	139,800
Percent changes in January 1991 since:				
Jan 1990	-4.5	3.2	-1.1	-6.0
Dec 1990	1.9	3.0	1.8	5.2

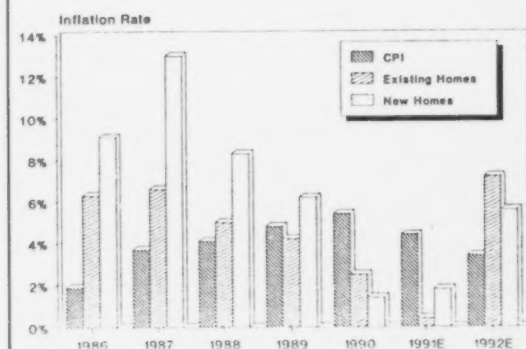
Source: National Association of Realtors, "Home Sales"

The national median existing single-family home price increased from \$91,700 in December to \$94,200 in January. The 2.7 percent increase probably reflects the concentration of higher-priced home sales, as the post-holiday market tends to consist of more affluent buyers.

In the market for new homes, the median price declined 4 percent to \$121,800 in January. This slowdown reflects the growth of new-home inventories, which stands at its highest level since April of 1982.

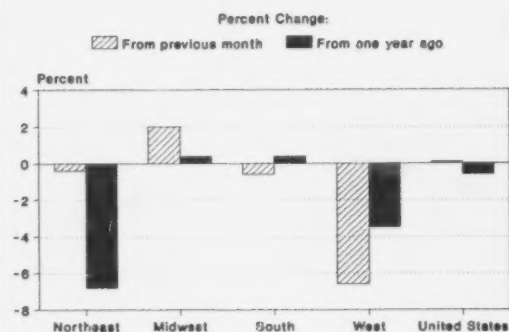
The average price of both existing and new single-family homes increased in January. An increase of 6.5 percent added \$7,400 to the price of an existing single-family home. New home prices grew by 2.6 percent, bringing the average price of a new single-family home to

Home Prices



Source: Bureau of Census; E Real Estate Outlook forecast

Home Prices by Region



Source: NAR Economics & Research

\$156,200.

Modest appreciation in the median price of existing single-family homes is expected over the next year, with an increase of 0.4 percent in 1991. Prices will begin to firm at year end and are projected to increase by 7.2 percent in 1992. New single-family home prices should experience slightly higher growth in 1991, with prices increasing by 1.8 percent. In 1992 the median price of new single-family homes will increase by 5.6 percent.

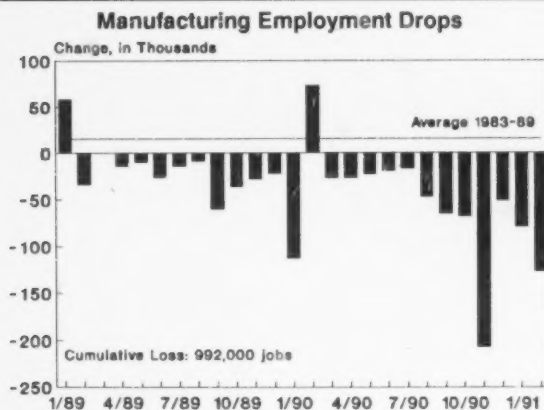
Robert D. Barr
Director of Forecasting

Kimberly A. Martin
Research Economist

Forecasting & Policy Analysis

The Keys to the Coming Recovery

The signs of recession are numerous: Housing starts seemingly hit bottom -- until the next month's report shows another decline. Sales of new homes are only two-thirds of last year's rate, and January's pace is the slowest since 1982. Existing home sales are not faring much better, with sales down 16 percent over last year. Meanwhile, the labor markets continue to sink as another 184,000 workers lose jobs in February and the unemployment rate reaches 6.5 percent. Consumer confidence in recent months has reached record lows, and the government's economic weathervane, the Index of Leading Economic Indicators, has pointed down for six consecutive months. How, then, can one find a recovery ahead when all seems to be gloom?



As discussed in the Outlook article on pages 2-3, confidence in a recovery is not necessarily related to the U.S.'s resounding success in the Persian Gulf. The resolution of the crisis suggests that oil prices will remain fairly tame and lightens the burden of uncertainty from consumers and businesses. This will contribute very importantly to America's recovery, but will not by itself propel the economy to recovery. The recession was largely a result of economic forces unleashed here in the states, not military forces unleashed in the Gulf. Any recovery must overcome these economic fundamentals, which cannot be washed away in a flood of renewed confidence.

There's plenty to suggest that the recession may drag on through the end of 1991, but, on the other hand, there's also some reason to think that March could mark the recession's end, once all the figures are available. On balance, however, the evidence suggests that recovery will take hold by mid-year, leaving in its wake only a relatively mild and short recession. While the current forecast calls for growth in the second quarter, the annual rate is so small -- 0.2 percent -- that we look to the third quarter's 3.1 percent rate as the first full quarter of recovery.

This article will briefly discuss the recovery phase of the typical business cycle and then look at several key areas of the economy which are flashing the green lights necessary to allow the economy to get its wheels turning again.

What We Can Expect: Lessons From Previous Recoveries

Generally speaking, recessions occur as businesses and consumers cut back on debt accumulation after going through a period of debt expansion. Consumers borrow to purchase homes, cars and vacations; businesses borrow to expand or purchase existing businesses. At some point, given current interest rates, inflation rates and income growth, the debt burden becomes too heavy. If it's sufficiently widespread, the resulting retrenchment leads to a recession.

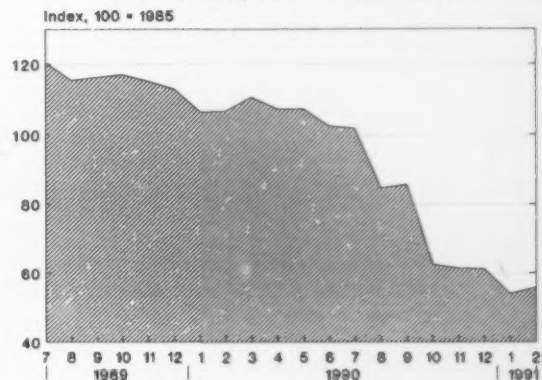
The seeds of the next recovery are planted during the preceding recession, which gives consumers and businesses time for a breather. Inflation and interest rates fall, and those who feel confident in maintaining their income level despite the recession are in position to take advantage of the lower interest rates, and so increase their spending. Meanwhile, reduced production improves labor productivity, which lowers the cost per unit of each good. Coupled with lower borrowing rates, the lower unit labor costs improve businesses' ability to expand.

The government plays an important role in the determination of the timing and duration of business cycles, particularly through its monetary policy. Consequently, the Federal Reserve's handling of credit policy is generally at the center of any story about recession and recovery.

Five Keys to Recovery

Federal Reserve Policy. The first key is the monetary policy pursued by the Fed, and this is most clearly seen in the so-called fed funds market. It's here that banks make overnight loans to other banks who are experiencing

Consumer Confidence Plummets, But Recovery Starts in February



The Fed Pushes Down on the Fed Funds Rate...

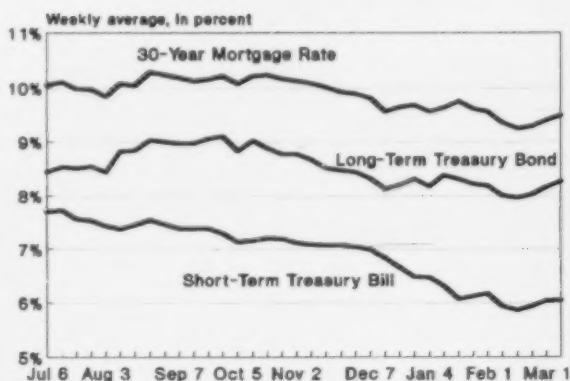


shortfalls in their required reserves. The rate charged is influenced by the Fed as it adds or drains reserves in the banking system through its daily operations. In acknowledgement of worsening economic conditions, the Fed has lowered its target range for the fed funds rate in the past few months, and consequently the market rate has fallen about 2 percentage points, as shown in the chart above. The current target rate of 6.0 percent was adopted on March 8, when the government released February's dismal employment report.

The lower fed funds rate generally translates into lower rates elsewhere in the banking system and enables banks to make more loans. This should then result in an increase in the money supply. There had been concern that the Fed's easing wasn't having its desired effect since money growth, as measured by the aggregate M2, had been so anemic in the fall and early winter (see chart below). But M2 growth finally perked up in February, according to preliminary figures. This is a signal of increased lending and, perhaps, a signal that consumers are ready to reach for their wallets once again.

In addition to lowering the fed funds target rate, the Fed pulled its two other policy levers at the end of 1990. First, the discount rate, the rate at which banks can borrow from the Fed, was cut twice by a half-point to bring it to 6 percent (it had been at 7 percent for nearly two years). According to some reports, the Fed also encouraged banks to make greater use of the discount window. Banks had been avoiding borrowing from the Fed since such moves were often seen by the market as a signal of problems at the bank. With confidence such an integral asset in a bank's survival, the higher rates charged in the fed funds market were often preferable to going to the Fed. Second, a rare and significant move towards easing the credit crunch came in December when the Fed lowered reserve requirements. This reduction, the first since 1983, freed up \$13 billion in reserves and will aid bank profitability. It is

...And Other Rates Drift Down

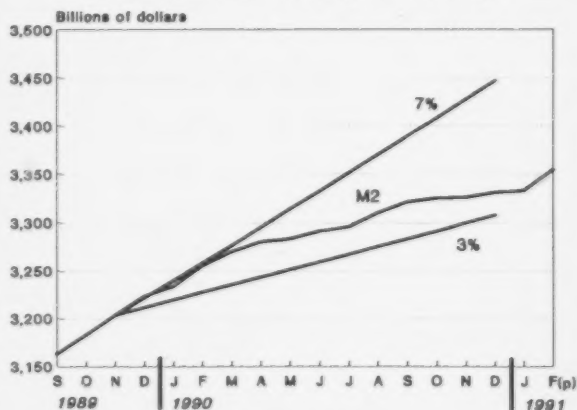


countered, however, by January's increase in FDIC premiums.

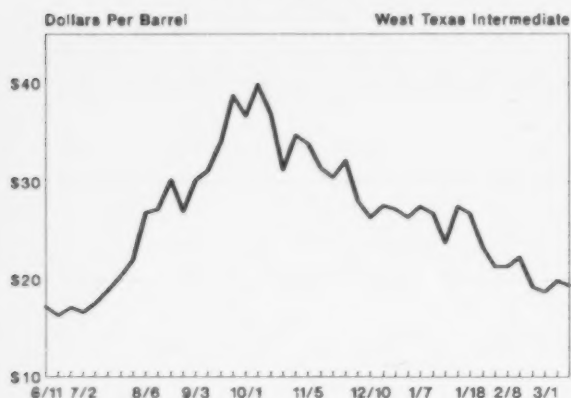
Inflation. While tight monetary policy may have pushed us close to a recession in the past couple of years, it has also kept the underlying inflation rate close to 4 percent -- not great, but far more manageable than the 12 percent rate preceding the 1981-82 recession. While special factors -- agricultural difficulties, the oil price shock, and increased excise taxes -- pushed inflation over 6 percent during 1990, inflation will probably remain subdued in coming quarters. A given increase in income means more purchasing power as inflation falls, and it's this improvement that generates the more economically fundamental boost in consumer confidence.

Inventories. As noted in the Outlook article, inven-

Money Growth Perks Up in February



Oil Prices Retreat, Bring Inflation Relief in '91



tories are playing a role which suggests that the big production cuts normally associated with recessions are not ahead of us. In fact, it appears that the cuts in production, and the concomitant loss of jobs, occurred in advance of the recession as the economy slowed during 1989 and 1990. The lean inventories seen in most industries suggests that the worst of the manufacturing job losses are behind us.

Corporate Profits. The first quarter of 1991 is expected to be the seventh quarter in the last nine that profits have fallen, but big increases are expected in the second half of this year and into 1992. One widely recognized sign that the recovery will be upon us within four to six months is the stock market, which is an indicator of corporate America's health. While it tends to predict recessions when the economy is merely slowing down, the stock market has a strong record in signaling oncoming recoveries.

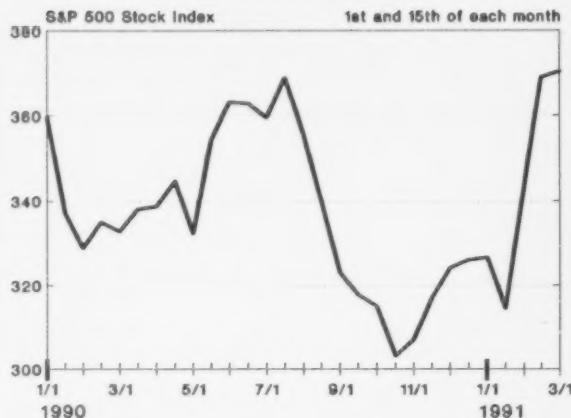
Housing. Anecdotal evidence from REALTORS® and surveys conducted by other housing trade associations show that the housing market may have turned the corner. Traffic appears to be up for both new and existing homes as buyers attempt to take advantage of soft prices and lower mortgage rates. This suggests an increased willingness on the part of consumers to make the financial stretch usually required to purchase new housing. This sense of confidence could only exist if these potential homebuyers felt secure in their jobs and income levels.

Other Contributors to the Recovery

There are other, scattered reports that the recession may be bottoming out soon. Many of these reports are preliminary, and there's a good chance that the positive changes will be reversed in upcoming months. Nevertheless, they add some insight into the depth of the recession.

For example, the Index of Leading Economic Indicators has declined for six consecutive months, as men-

The Stock Market Signals Go



tioned earlier. Yet the declines in December (-0.1 percent) and January (-0.4 percent) were substantially smaller than the previous four declines, which averaged just over 1.0 percent. Further, two components of the index, the stock market and the money supply, have already recorded sharp gains in February, suggesting that the overall index will rise in February.

Exports performed well in the second half of 1990, expanding at a 7.0 percent annual rate. They moderated the beginning of the downturn and were thought to be a major source of strength in 1991. While exports will continue to grow, their expected contribution has been trimmed considerably due to overseas recessions and expectations that the dollar may appreciate over the next several quarters, following its sharp appreciation during February. Exports are expected to grow about 3.5 percent in 1991, down from 1990's 6.2 percent performance.

Another mixed indicator that still shows signs of snapping back is durable goods orders. They plunged 10 percent in November but rose 3 percent in December. January saw orders fall again, but this time only by 1.8 percent. This pattern is more consistent with a business cycle near its trough rather than one with more massive declines in store.

Finally, preliminary figures for retail sales show a healthy rebound in February, with a strong gain in durable goods leading total sales to advance at a 9.7 percent annual rate.

By Robert D. Barr
Director of Forecasting
Forecasting & Policy Analysis

Sources: Employment Data -- Bureau of Labor Statistics; Consumer Confidence Index -- The Conference Board; Interest Rates and Money Supply -- Federal Reserve Board; Oil Prices -- DRI, Inc.; S&P 500 -- Wall Street Journal.

ON THE PRESIDENT'S 1992 BUDGET: DEFICIT, DEBT, AND PROPOSALS AFFECTING REAL ESTATE

On February 4, the President sent his budget to Congress proposing record spending of \$1.446 trillion and forecasting revenue of \$1.165 trillion for fiscal 1992 ending September 30, 1992. These spending numbers are considered optimistic since they do not include the cost of Operation Desert Storm.¹ Most of the President's proposals are virtually the same as those he submitted last year. With the deficit topping \$300 billion this year, there is little room for big spending programs. The President continues to seek a capital gains tax cut, penalty-free withdrawals from Individual Retirement Accounts (IRAs) for first-time homebuyers, and enterprise zones. He also proposed to extend for one year a number of expiring provisions such as the low-income housing tax credit and health insurance deduction for self-employed individuals.

The Deficit Projection

The federal budget has not been balanced since 1969. The President's budget proposals project the largest deficits in U.S. history -- \$318.1 billion in the current fiscal year and \$280.9 billion in fiscal 1992.² The federal budget continues to be encumbered in the short term by the costs of the savings and loan bailout, which are expected to be relatively high compared to other spending programs in the budget. For example, for fiscal 1991, the expected costs of covering deposit insurance losses totalling \$112 billion are far greater than the combined actual budgets of the Departments of Education, Housing and Urban Development (HUD), Transportation, and Veterans Affairs which in fiscal 1990 totalled \$101 billion.

According to the Office of Management and Budget (OMB), an agency that keeps tabs of the Administration's budget, however, deposit insurance costs will decline rapidly after fiscal 1992. In the longer term, the disposition of assets the government has acquired from failed savings and loan institutions will bring in more revenue, making significant contributions to reducing the deficit. For example, in fiscal 1995 when the deficit is projected to be only \$3 billion, the deposit insurance programs are expected to bring in \$42 billion of revenue, a large swing from the \$112 billion costs incurred in this fiscal year. The Administration's forecasts of rapidly falling deficits in the longer term also rest on the assumption that the economy would quickly strengthen and remain strong through 1996.

Figure 1
Total Federal Deficit, 1984-1996
Actual and Forecast in the 1992 Budget

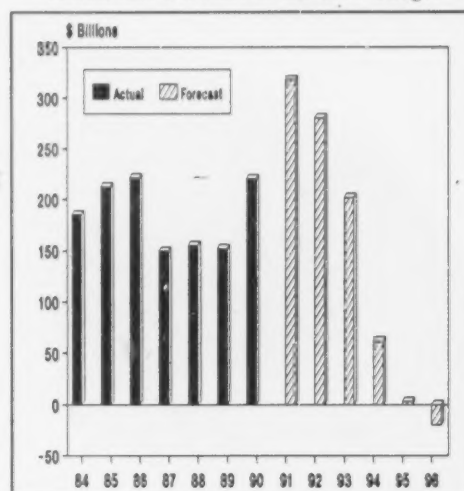


Figure 1 shows the historical data on the actual deficit from fiscal 1984 to 1990 and the projected deficit from 1991 to 1996. Following the record-high projected deficit of this year and next year, the projected deficit is nearly eliminated by fiscal 1995 and the budget is in surplus in fiscal 1996.

The Public Debt Limit and the President's Proposal

The Omnibus Reconciliation Act of 1990 (OBRA), passed last November, increased the permanent limit on the debt by roughly \$1 trillion, to \$4.145 trillion. The debt outstanding subject to the limit in late February 1991 was approximately \$3.35 trillion.³ Therefore, there is unused debt authority to accommodate future projected deficits.

Figure 2 shows the federal debt held by the public at the end of fiscal year as a percent of gross national product (GNP) by decade from 1940 to 1992.⁴ The average public debt-GNP ratio was as high as 79 percent during the 1940s and as low as 27 percent during the 1970s. At one point, the ratio was as low as 24.3 percent in 1974 and never exceeded 40 percent between 1965 and 1985. The projected public debt-GNP ratio for fiscal 1991 is 48.4 percent, a proportion not seen since 1958.